

## CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 298

April 23, 1965

### CORPORATE REORGANIZATION: COMMENCING CORPORATION

#### Syllabus:

On December 30, 1960, X Manufacturing Co., a wholly-owned subsidiary of Y Company, dissolved and transferred its assets to the parent. This transfer constituted a reorganization as defined in Section 23251 of the Bank and Corporation Tax Law. X had been doing business in California since 1956, and had paid its franchise tax for the taxable year 1960 measured by its net income for the year 1959. Y commenced to do business on January 4, 1960, and at the date of the reorganization was a commencing corporation subject to the provisions of Section 23222.

Pursuant to this section, Y's tax for the taxable years 1960 and 1961, respectively, is measured by its net income for the year 1960. However, in the case of a reorganization, there is a requirement in Section 23253 that the transferor's income for the taxable year in which the transfer occurs shall be included in the measure of tax on the transferee for the taxable year succeeding the taxable year in which the transfer occurs. Accordingly, X's net income for the year 1960 is includible in the measure of Y's tax for the taxable year 1961. Since, under the commencing corporation provisions, the measure of Y's tax for each of the taxable years 1960 and 1961 is its net income for the income year 1960, a question has been raised as to the effect of Section 23253 on the measure of Y's tax for the taxable year 1960.

Section 23253 provides that the income of a transferor for the period prior to the date of reorganization shall be reported by the transferee. If the transfer occurs in a taxable year of the transferee which ends at the same time as or before the taxable year of the transferor, the income is included in the transferee's return [23253(a)]. If the transfer occurs in a taxable year of the transferee which ends after the taxable year of the transferor, the transferee must file a separate return for such income [23253(b)]. The last sentence of paragraph (a), which reads "Income of the transferor so included in the measure of the tax on the transferee shall be considered the income of the transferee for the purpose of Chapter 2" has raised the question stated above in the case where the transferee is a commencing corporation.

In the case where a transferee corporation is a commencing corporation, Reg. 23251-54 provides that "its tax for the period in which the reorganization occurred shall be measured by its entire income, including income derived from the business and property transferred subsequent to the date of

reorganization." We have been asked whether the "entire income" of the transferee is intended to include the income of the transferor for the period prior to reorganization, as well as after reorganization, particularly when taken in conjunction with the last sentence of Section 23253(a), which is set out above.

We do not believe that the language in the statute and regulation can properly be construed to mean that the income of a transferee that is a commencing corporation for the period in which the reorganization occurred includes the income of the transferor for the period prior to the reorganization. We feel that the word "entire" is used only to emphasize the phrase that follows, namely, "including income derived from the business and property transferred subsequent to the date of reorganization." Likewise we are of the opinion that the language of the last sentence of Section 23253(a) does not support the result suggested by the question asked. The inclusion of the word "so" in the sentence is, in our opinion, particularly significant. The use of that word causes the provisions of the sentence to refer back to previous language of the paragraph, namely, "The net income of the transferor . . . included in the measure of the tax . . . for the taxable year succeeding the taxable year in which the transfer occurs . . . ." In this construction of the sentence, it applies only to the measure of the tax for the succeeding taxable year, and not to the taxable year of the transferee in which the transfer occurs. Furthermore, to construe Section 23253(a) as suggested to us would result in unjustifiable discrimination in favor of those transferees required to report the transferor's operations in a separate return under Section 23253(b). This latter subsection contains no provision similar to the last sentence of Section 23253(a). Accordingly, the income reported in the separate return under 23253(b) would clearly not be subject to the commencing corporation provisions. The only factual difference between the two cases, which is that under Section 23253(b) the transferee's taxable year ends at a later date than the transferors, does not appear to justify different treatment; and thereby supports our conclusion that the words "its entire income" refer only to the actual income of the transferee, with respect to the period prior to the date of reorganization. Such an interpretation accords with our views of commencing corporation taxation principles, particularly where the transferor has already prepaid its tax for the period it operated in the year of reorganization.

Finally, we suggest that the purpose of the last sentence of Section 23253(a) can be ascertained by referring to its predecessor provision (Section 13(i) of the Franchise Tax Act of 1939). It appears that the provision is intended to cover such considerations as the time at which the tax is due and the liability of the transferee with respect to income of the transferor so included in the measure of the tax on the transferee.